



A Wall St Perspective on Defense

NDIA Robotics Quarterly Meeting

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Defense Industry Investment Summary

2008 Defense Investing Themes

It's Still Cyclical

“Defensive”
Qualities

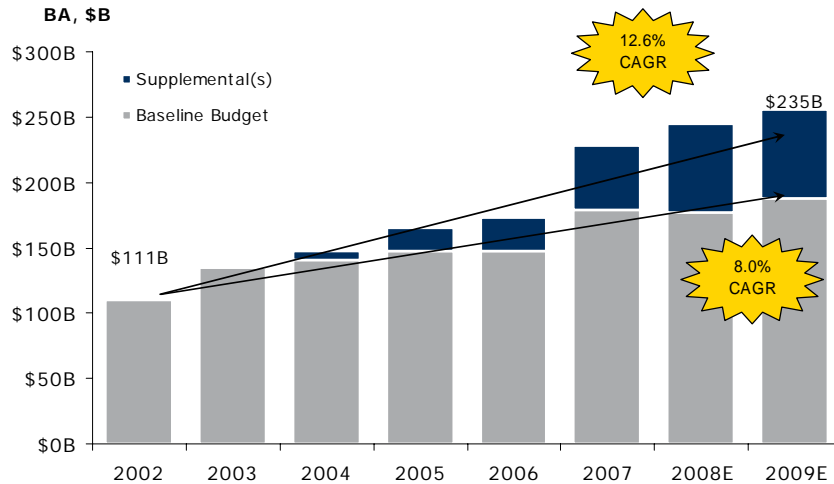
Election-
year/Iraq
Overhang

Valuation on Defense Stocks Reflects:

- Decelerating budget environment
- Double-digit EPS growth through 2009 vs. S&P's estimated 7% growth
- Long-term visibility from backlogs/budgets
- Free cash flow after dividends of \$15B+ over 2008/09 leaves plenty to deploy in acquisitions, dividend increases and share repurchase
- Growth opportunities (acquisitions and organic) beyond typical weapons spending include homeland security, federal IT, and MRO

Defense Budget Dynamics

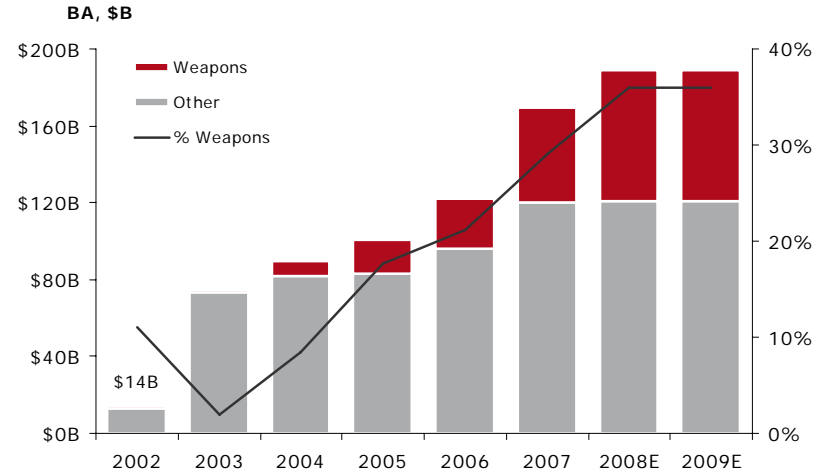
Weapons Spending Budget Authority (BA)
Supplemental Authorization Impact



Source: Department of Defense and Oppenheimer & Co. Inc.

Supplemental Appropriations have protected baseline budgets, providing a boost to budget authority above and beyond those seen during past conflicts...

Supplemental Appropriations (BA)
Weapons Spending Allocation



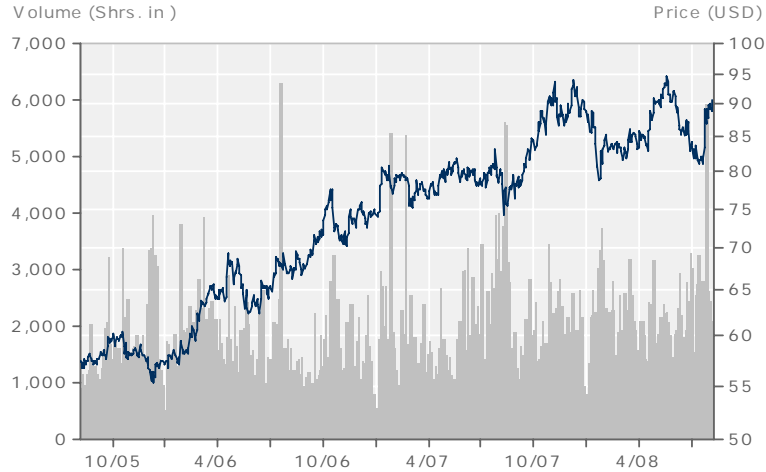
Source: Department of Defense and Oppenheimer & Co. Inc.

...while weapons Spending has garnered an increasing share of them, in stark contrast with past history, when the focus was on Operations & Maintenance

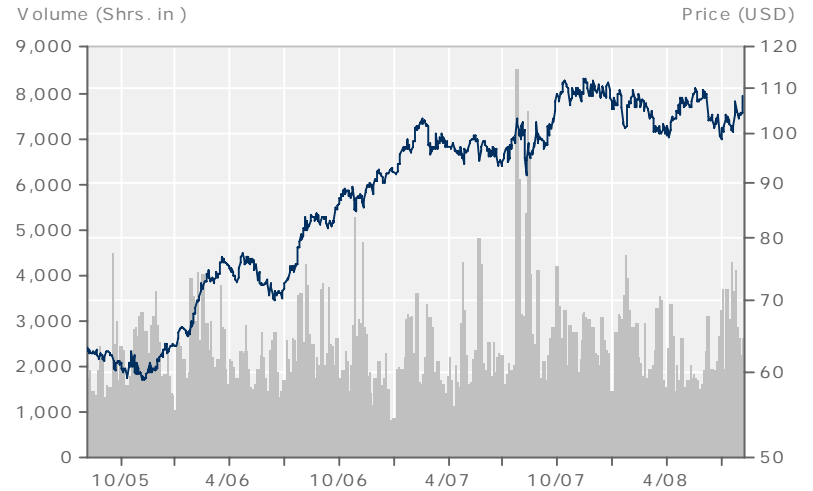
The use of Supplemental Appropriations is unprecedented, protecting ongoing programs and bolstering budgets of war-torn equipment

Enviably Stock Charts Performance

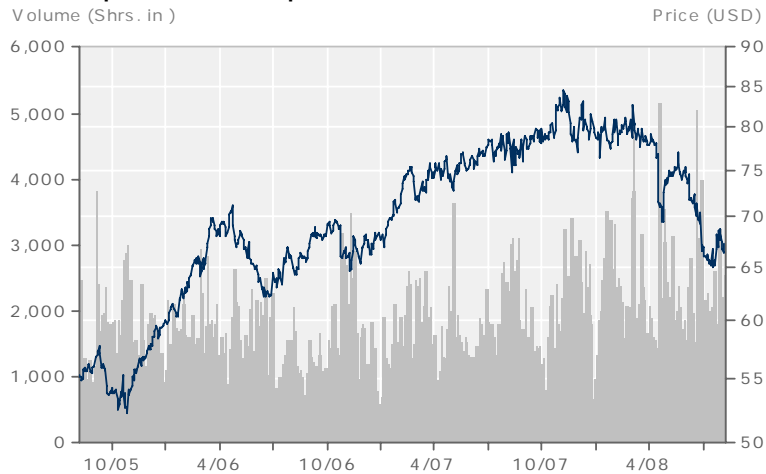
General Dynamics Corp.



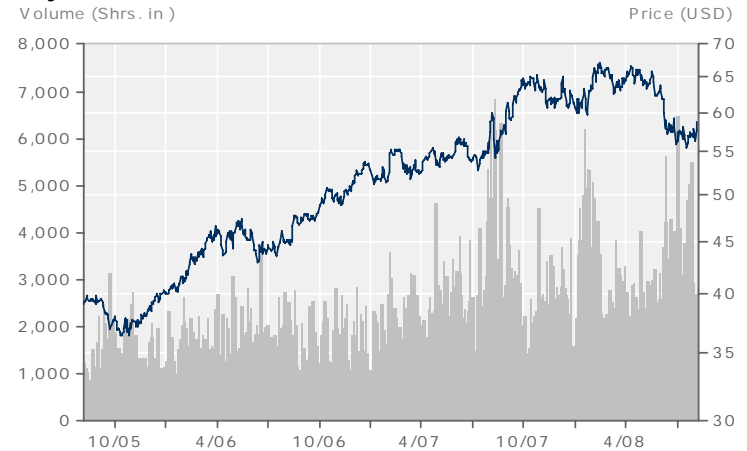
Lockheed Martin Corp.



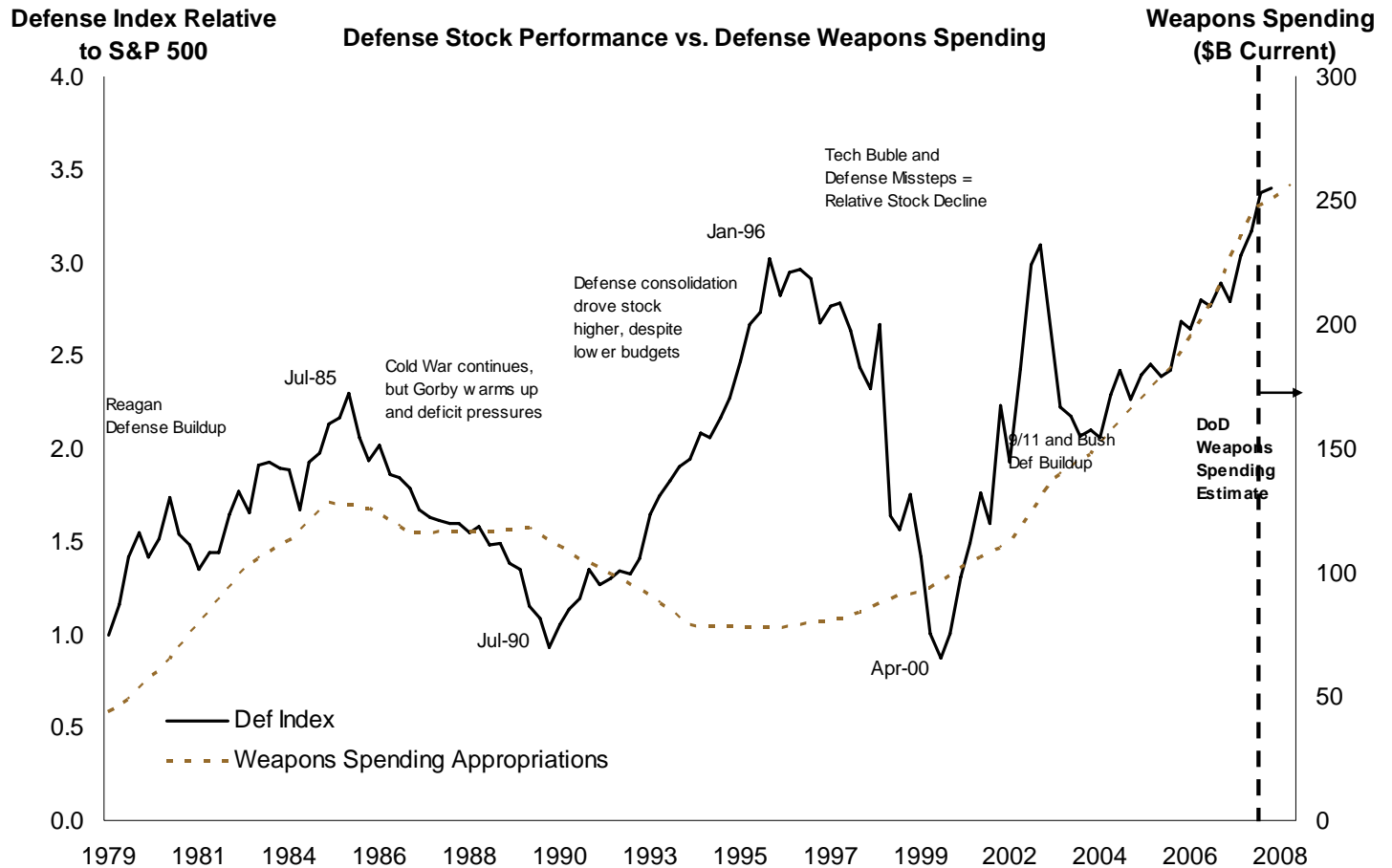
Northrop Grumman Corp.



Raytheon Co.



Budgets and Stocks



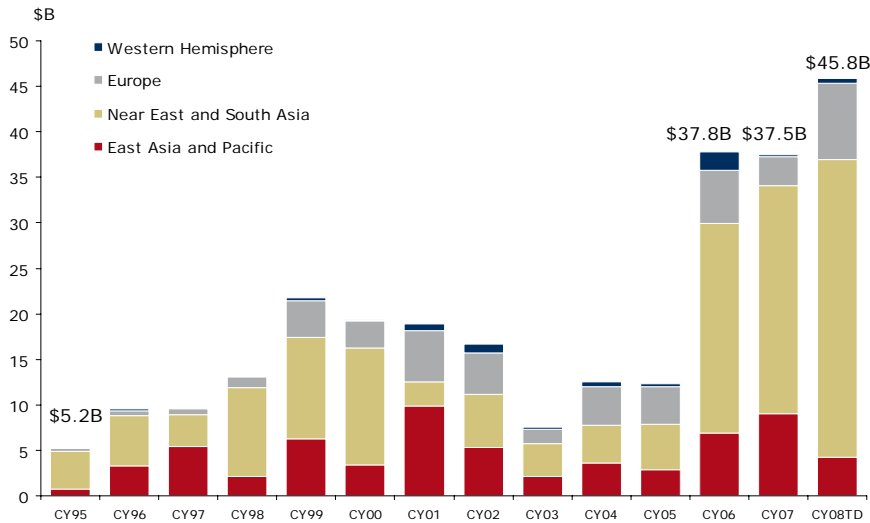
Stocks include: NOC, GD, LMT, RTN, LLL, ATK, McDonnell Douglas, E-Systems, Martin Marietta, Grumman

Source: Department of Defense and Oppenheimer & Co. Inc.

Where the US Defense Budget Goes, So Too Will Defense Stocks

Diplomacy Through Arms

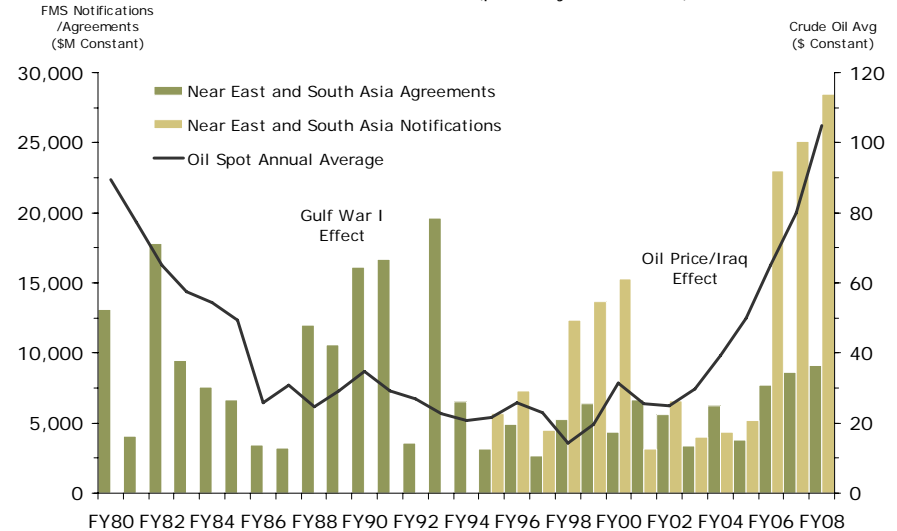
Foreign Military Sales (FMS) Notifications
by Region 1995-2008YTD



Source: Department of State and Oppenheimer & Co. Inc.

FY06 & FY07 FMS notifications exceeded the previous three years combined, pace extending to FY08.

Oil Prices vs. FMS Notifications/Agreements
Near East and South Asia (primarily Middle East)



Source: DoD DSCA FY89-05 Fact Books, Congressional Notifications (FY06 estimate), and Oppenheimer & Co. Inc.

Buoyed by surging oil revenue, Middle Eastern countries are leading the pack.

International business, often having been pursued for years and at great expense, is accelerating and often carries much higher margin

Consolidation Will Continue

*Consolidating the supply base,
plenty of deals
are still being done ...*

U.S. Industrial Base

BA, GD, LMT, NOC, RTN
CSC, GE, HON, LLL, SAI, UTX
ATK, Booz, Bechtel, COL, DRS, GR, KBR, HRS, ITT, TXT, URS
ARINC, Battelle, CAI, CUB, EDS, MANT, OSK, TDY (and hundreds of others)

Defense-related M&A

<u>Year</u>	<u>Transactions</u>	<u>Price/Sales</u>
1993	233	NA
1994	243	NA
1995	228	NA
1996	237	1.04
1997	251	1.15
1998	573	1.63
1999	173	1.30
2000	207	1.30
2001	343	1.15
2002	252	1.04
2003	307	1.41
2004	322	1.24
2005	371	0.85
2006	377	0.78
2007	334	1.03
2008*	273	1.05

Source: Infobase Publishers, Inc
*Through Aug 2008

*Transatlantic deals and army focused deals have been some of the
latest trends in larger M&A transactions*

...though Prime Consolidation Less Likely

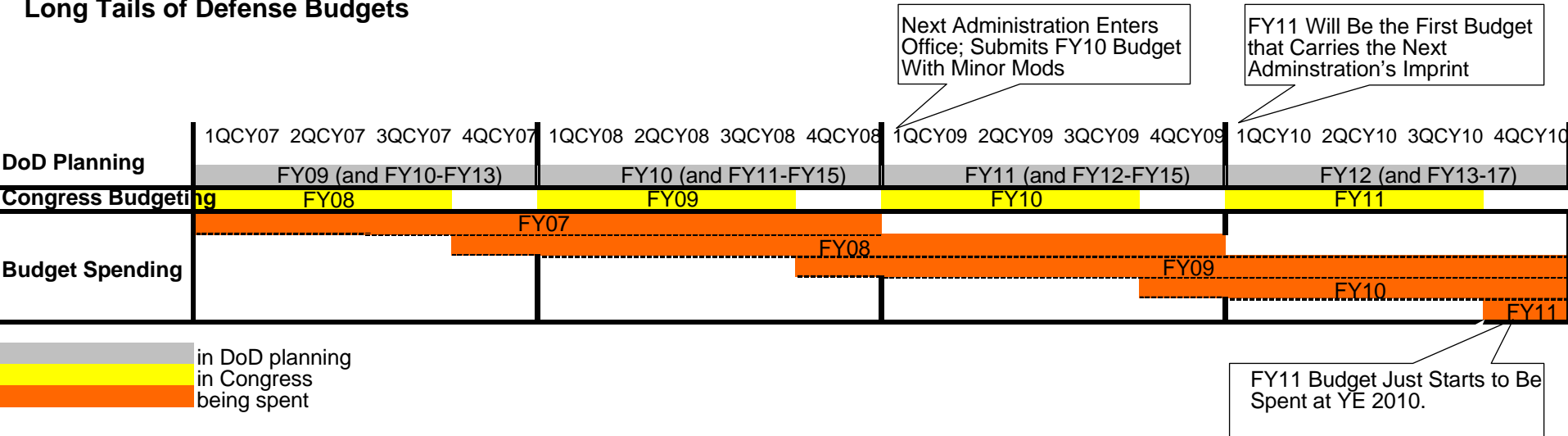
US Prime Contractors in Defense Market

Sector	Contractor Reduction (1990-2007)		1990 contractors	2007 Contractors
Tactical Missiles	13 to 4		BA, Ford Aero, GD, Hughes, Lockheed, Loral, LTV, Martin Marietta, McDonnell Douglas, Northrop, Raytheon, Rockwell, Texas Instruments	BA, LMT, NOC, RTN
Fixed Wing Aircraft	8 to 3		BA, GD, Grumman, Lockheed, LTV-Aircraft, McDonnell Douglas, Northrop, Rockwell	BA, LMT, NOC
Expendible Launch Vehicles	6 to 2		BA, GD, Lockheed, Martin Marietta, McDonnell Douglas, Rockwell	ULA (BA/LMT JV), ORB
Satellites	8 to 6		BA, GE, Hughes, Lockheed, Loral, Martin Marietta, TRW, Rockwell	BA, LMT, NOC, Loral, GD (Spectrum Astro), ORB
Surface ships	8 to 2		Avondale Industries, Bath Iron Works, Bethlehem Steel, Ingalls Shipbuilding, NASSCO, Newport News, Tacoma, Tampa	NOC, GD
Tactical Wheeled Vehicles	6 to 5		AM General, Harsco, GM Canada, Oskosh, Stewart & Stevenson, Teledyne Cont. Motors	AM General, GD, Oskosh, BAE Systems, FRPT
Tracked Combat Vehicles	3 to 2		FMC, GD, Harsco	GD, BAE Systems
Strategic Missiles	3 to 2		BA, Lockheed, Martin Marietta	BA, LMT
Torpedoes	3 to 2		Alliant Tech Systems, Hughes, Westinghouse	NOC, RTN
Rotary Wing	4 to 3		Bell Helicopters, BA, McDonnell Douglas, Sikorsky	Bell, BA, Sikorsky

Source: 1998 Data; GAO: Defense Industry: Consolidation and Options for Preserving Competition (Letter Report, 04/01/98, GAO/NSIAD-98-141).

Long Tails Extend into Next Admin

Long Tails of Defense Budgets



The Next Administration FY11 Imprint Budget Starts to Flow to Contractors in FY11

Multi-year Visibility

Backlog Analysis

<i>(\$MM)</i>	2003A	2004A	2005A	2006A	2007A
General Dynamics Total*	34,332	34,905	34,136	35,974	34,576
Lockheed Martin Total	76,899	73,986	84,188	75,900	76,700
Northrop Grumman Total	58,154	58,080	55,983	61,021	64,059
Raytheon Total*	25,087	29,611	31,248	33,595	36,614

<i>(% Growth)</i>	2003A	2004A	2005A	2006A	2007A
General Dynamics Total*	57%	2%	(2%)	5%	(4%)
Lockheed Martin Total	9%	(4%)	14%	(10%)	1%
Northrop Grumman Total	NA	(0%)	(4%)	9%	5%
Raytheon Total*	19%	18%	6%	8%	9%

<i>Yrs B/L on Next Year's Sales</i>	2003A	2004A	2005A	2006A	2007A
General Dynamics Total*	1.8	1.6	1.4	1.3	1.2
Lockheed Martin Total	2.2	2.0	2.1	1.8	1.8
Northrop Grumman Total	1.9	1.9	1.9	1.9	1.9
Raytheon Total*	1.4	1.6	1.6	1.6	1.6

* *Defense Business Only*

Source: *Oppenheimer & Co. Inc. estimates and company reports.*

*Solid and rising backlogs add to out-year visibility
Cash generation remains strong
and deployment comes into focus*

Profit and Defense...ROIC Focus Shines

Large-Cap Defense Margin Picture

Segment Margins	1999A	2000A	2001A	2002A	2003A	2004A	2005A	2006A	2007A	2008E	Change 1999-2008
General Dynamics	13.4%	12.9%	12.3%	11.4%	8.8%	10.1%	10.3%	10.9%	11.4%	12.2%	(121) bps
Lockheed Martin	6.9%	7.0%	7.1%	7.6%	7.8%	8.4%	9.2%	10.2%	11.2%	11.5%	458 bps
Northrop Grumman	8.7%	8.9%	7.7%	6.0%	7.3%	7.7%	8.0%	9.3%	9.8%	8.6%	(10) bps
Raytheon	10.0%	10.6%	7.8%	9.6%	8.5%	11.3%	11.4%	12.9%	13.2%	12.9%	288 bps

Large-Cap Defense ROIC Picture

ROIC*	1999A	2000A	2001A	2002A	2003A	2004A	2005A	2006A	2007A	2008E	Change 1999-2008
General Dynamics	18.2%	19.9%	18.2%	16.1%	11.8%	12.7%	13.5%	14.8%	15.5%	16.6%	(162) bps
Lockheed Martin	11.5%	6.4%	7.5%	10.2%	12.8%	15.7%	19.3%	22.9%	25.1%	22.8%	1,131 bps
Northrop Grumman	6.9%	7.4%	6.2%	2.7%	5.3%	6.4%	6.7%	8.3%	9.4%	8.1%	117 bps
Raytheon	4.4%	4.3%	3.1%	5.9%	5.9%	8.0%	8.3%	10.1%	11.5%	12.3%	787 bps

The key to success by defense contractors this cycle has not been a operating margin story as much as it has been a return on invested capital

*ROIC corrected for pension and unusual items

Doth Protest?

	<u>FY02</u>	<u>FY03</u>	<u>FY04</u>	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>
Cases filed	1204	1352	1485	1356	1327	1411
Cases closed	1133	1244	1405	1341	1274	1393
Merit	256	290	365	306	249	335
<i>% Cases Closed</i>	23%	23%	26%	23%	20%	24%
Sustains	41	50	75	71	72	91
<i>% of Merit</i>	16%	17%	21%	23%	29%	27%
<i>% of Case Closed</i>	4%	4%	5%	5%	6%	7%

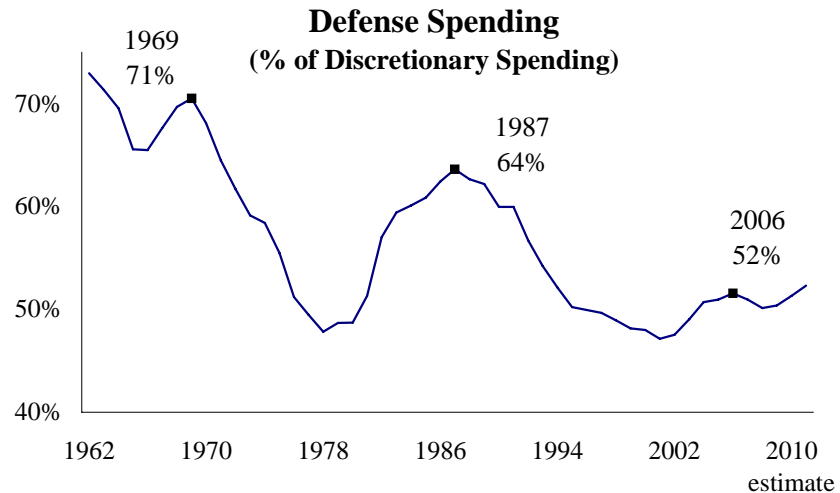
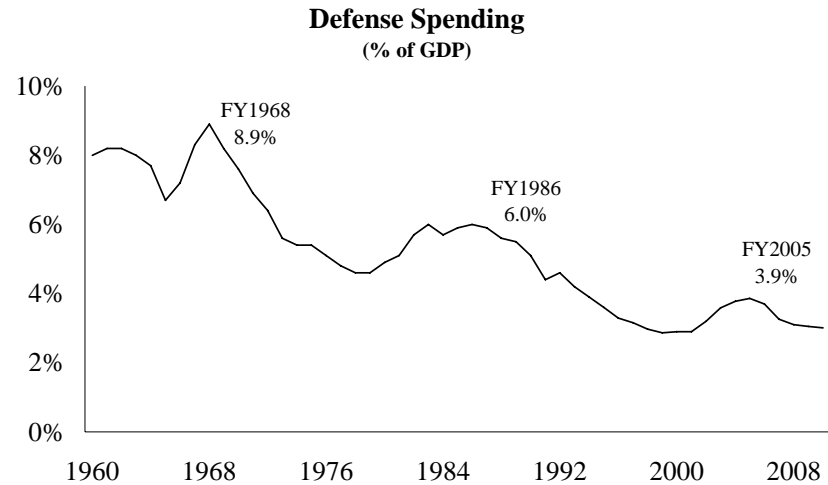
- Protests are up 25%, but sustain decisions are up 120% since '02
- When there's no downside to protest, why not?
- \$1,000/hr lawyers likely have the upper hand poking holes
- If we can't have it, no one can is sometimes the best strategy

Case For Higher Defense Spending

■ *Constant \$ basis suggests to us that there's still upside in the cycle if threat persists*

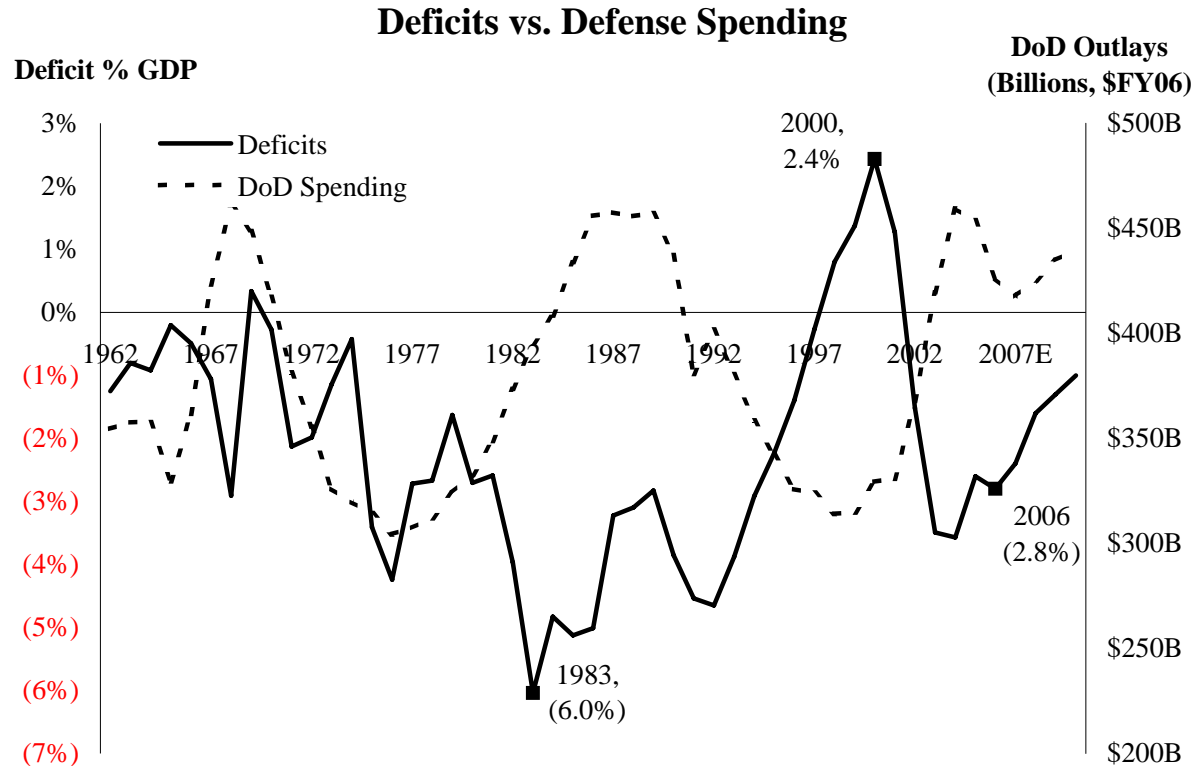
■ *Defense spending is still near historical lows as % of GDP*

■ *Defense down to around 50% of discretionary spending*



Source: OMB, Department of Defense and Oppenheimer & Co. Inc.

How the Credit Crisis Will Affect Defense



Source: OMB, Department of Defense and Oppenheimer & Co. Inc. estimates.

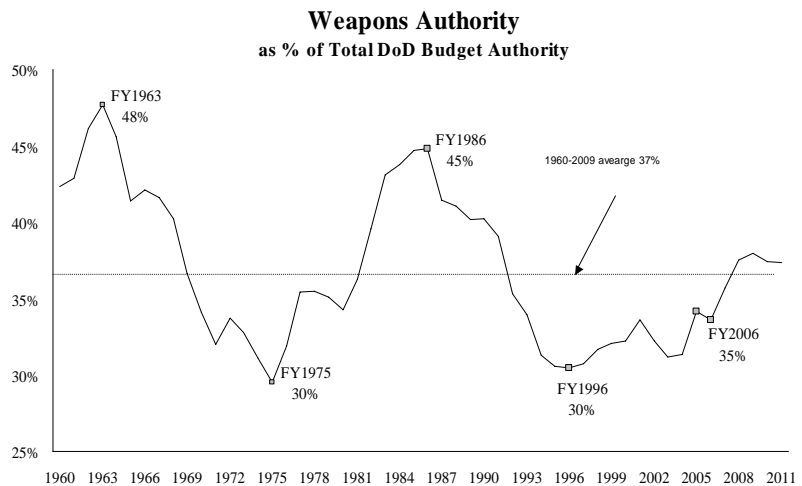
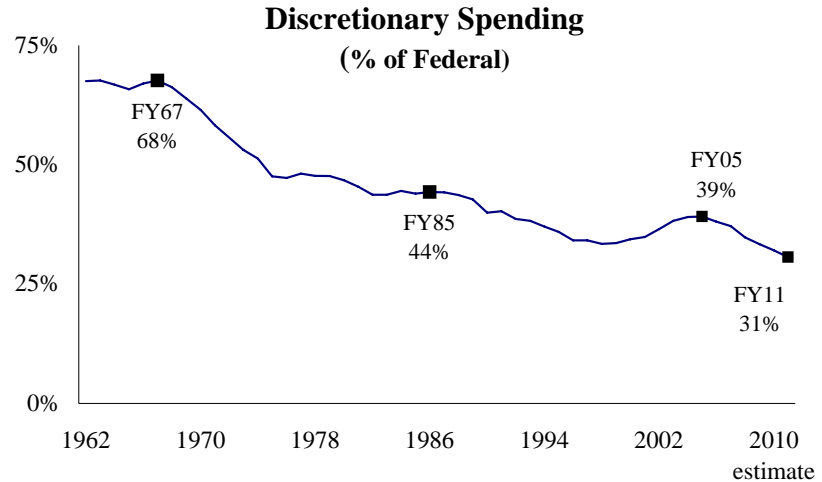
*Deficits were the last defense upcycle killer —
We remain watchful at current deficit spending levels.*

Case Against Higher Defense Spending

■ *Deficits are rising and could potentially go higher*

■ *Social Security effect is cutting into overall discretionary spending*

■ *O&M costs from ongoing operations and aging equipment could funnel money away from weapons, ex-supplementals*

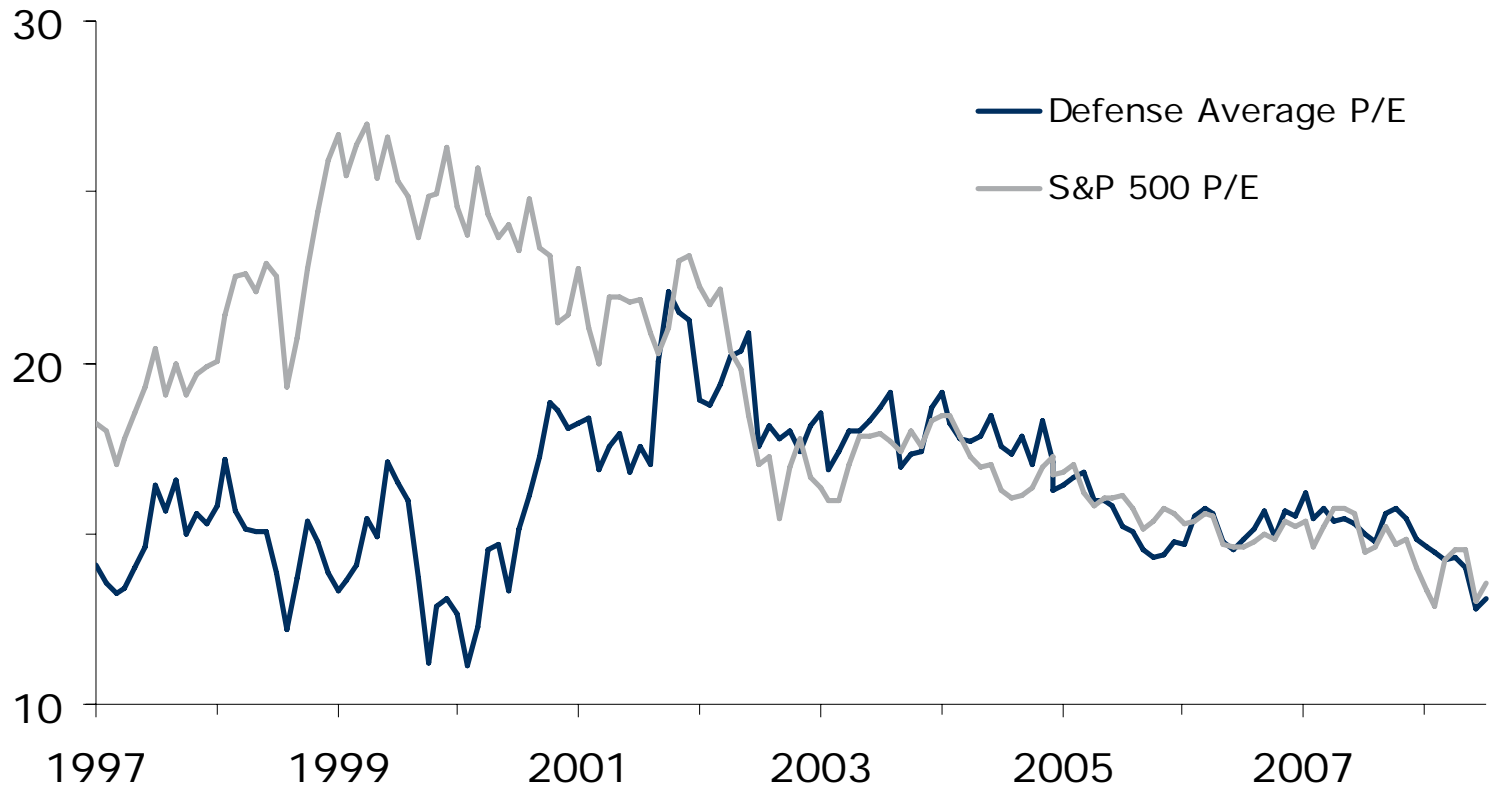


Source: OMB, Department of Defense and Oppenheimer & Co. Inc.

Relative Repricing Always A Concern

P/E Trends

S&P and Large-cap Defense



*...though Something We Don't See Likely
Anytime in the Near-term*